

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WASHINGTON

In Re:
LLS AMERICA, LLC,
Debtor

NO: 12-CV-488-RMP

10 BRUCE P. KRIEGMAN, solely in his
11 capacity as court-appointed Chapter 11
Trustee for LLS America, LLC,

Adv. Proc. No. 11-80285-FPC11

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Plaintiff.

v.
DORIS NELSON and ADAM
NELSON, and the marital community
comprised thereof; et al.,

Defendants.

A bench trial was held on October 1, 2014. Plaintiff was represented by

19 Thomas Cochran and Daniel Gibbons from Witherspoon Kelly. Pro se defendants
20 Harold Johanson and Colt Johanson were not present. Plaintiff stated that the pro

1 se defendants had been given notice of the trial and that they did not respond. For
2 reasons explained on the record and in a prior order, Plaintiff did not present
3 evidence concerning any defendants other than Harold Johanson and Colt
4 Johanson. *See* ECF No. 91.

5 The Court heard witness testimony and, having reviewed the admitted
6 exhibits and being fully informed, makes the following findings of fact and
7 conclusions of law:

8 PREVIOUS RULINGS

9 1. Ponzi Scheme and Insolvency

10 On July 1, 2013, the Bankruptcy Court issued its Report and
11 Recommendation Re Plaintiff's Motion for Partial Summary Judgment on
12 Common Issues ("Report and Recommendation") recommending that the District
13 Court grant the Trustee's Amended Motion for Partial Summary Judgment on two
14 "Common Issues": (1) Debtor operated a Ponzi scheme; and (2) Debtor was
15 insolvent at the time of its transfers to Defendants. On August 19, 2013, this
16 Court adopted the Bankruptcy Court's Report and Recommendation and entered
17 an order granting the Trustee's Amended Motion for Partial Summary Judgment
18 on the Common Issues ("Order Adopting Report and Recommendation"). *See*
19 2:11-cv-00357-RMP, ECF No. 92. Therefore, this Court has determined that
20

1 Debtor operated a Ponzi scheme and was insolvent at the time of each of the
2 transfers to Defendants.

3 All of the findings and conclusions set forth in the Report and
4 Recommendation and the Order Adopting Report and Recommendation are
5 incorporated by this reference and are the law of this case.

6 **2. Omnibus Hearing for the Testimony of Charles B. Hall**

7 On January 31, 2014, this Court entered its Order Granting Plaintiff's
8 Motion for Omnibus Hearing. ECF No. 42. Pursuant to that Order, the court-
9 appointed examiner, Mr. Charles B. Hall, testified at an Omnibus Hearing in open
10 court commencing on February 25, 2014. His testimony consists of written direct
11 examination testimony that was filed on or about February 17, 2014, and the oral
12 testimony that he gave at the Omnibus Hearing. Mr. Hall was cross examined by
13 several defense attorneys and by some pro se defendants. Mr. Hall's testimony at
14 the Omnibus Hearing is part of the record in this adversary action.

15 **FINDINGS OF FACT**

16 1. Debtor is the Little Loan Shoppe group of companies, which was
17 formed originally in 1997. PO-1 at 11.

18 2. Debtor operated a Ponzi scheme, whereby investors' loans sometimes
19 were used to pay other investors' promised returns on investments. PO-1 at 16.

1 3. Over the course of its existence, Debtor acquired approximately
2 \$135.4 million in funds invested by individual lenders, documented by promissory
3 notes promising interest in the range of 40% to 60% per annum. PO-1 at 7 n.2, 15.

4 4. Debtor accumulated payday loan bad debts of approximately \$29
5 million, which were written off in 2009. PO-1 at 41.

6 5. Debtor was never profitable at any time during its existence, and at no
7 time did it generate sufficient profits to pay the amounts due the lenders. PO-1 at
8 16, 53.

9 6. All of the transfers that the Trustee seeks to avoid were made within
10 the period of September 1997 to July 21, 2009. P-81; P-91.

11 7. Indicia and characteristics of the Ponzi scheme present in this case
12 include:

13 a. Proceeds received from new investors masked as profits from
14 running a payday loan business; PO-1 at 16, 22;

15 b. Promise of a high rate of return, usually between 40% to as
16 much as 60%, on the invested funds; PO-1 at 19;

17 c. Debtor paid commissions to third parties who solicited new
18 lenders, typically 10% annually of the amount received from the new
19 lender; PO-1 at 20-21;

1 d. Debtor solicited funds as loans evidenced by promissory notes
2 but demonstrated a pattern of “rolling over” the promissory notes when due
3 onto new notes instead of paying off the obligation; PO-1 at 26;

4 e. Debtor, throughout its history, made false and misleading
5 statements to current and potential lenders; PO-1 at 53-54;

6 f. Debtor was insolvent from its inception to the filing of its
7 bankruptcy; PO-1 at 67.

8 8. The court-appointed examiner, Charles B. Hall, by way of education,
9 experience, and vocation, is qualified to analyze and review the legitimacy of an
10 enterprise’s operation and to detect a fraud based on Ponzi scheme operations.

11 9. Mr. Hall’s expert opinion is credible.

12 10. Curtis Frye’s testimony, which pertained to Debtor’s record keeping
13 and the accounting, is credible.

14 11. Harold Johanson is Doris Nelson’s father. Colt Johanson is Doris
15 Nelson’s brother.

16 12. Harold Johanson received multiple payments from Debtor. *See* P-81.
17 Plaintiff argued that Harold Johanson received a total of \$7,762.66. However, a
18 check offered in support of a \$473.66 transfer to Harold Johanson was made
19 payable to Andrea Barnett. P-81 at 5. Although a note on the bottom of the check
20 states “Johanson,” it is unclear whether the funds were intended for Harold

1 Johanson. The Court finds that evidence of this payment to Harold Johanson is
2 insufficient. Therefore, the Court will not include this payment in its accounting.

3 13. Other payments to Harold Johanson are supported by checks that are
4 payable to “Cash” and that indicate that they are “for H. Johanson.” *See, e.g.*, P-81
5 at 3. The Court finds that Plaintiff offered sufficient evidence to establish that
6 Harold Johanson received \$6,122.34 in Canadian currency, shown by checks
7 drawn on a Canadian bank, and \$1,166.66 in United States currency, proven by the
8 receipt for a cashier’s check that Little Loan Shoppe America purchased from
9 Bank of America. *See* P-81.

10 14. There is no evidence that Harold Johanson worked for Debtor in
11 exchange for the transfers.

12 15. A demand letter written in May 2001 by Harold Johanson’s attorney
13 indicates that Debtor issued Harold Johanson promissory notes for a total of
14 \$20,000 and owed him \$5,000 that he had advanced to Debtor. P-81 at 12.
15 However, Mr. Frye testified that he could not find any evidence that Debtor had
16 received anything in exchange for the payments to Harold Johanson. The Court
17 finds that there is not sufficient evidence to show that Harold Johanson contributed
18 funds to Debtor.

19 16. Colt Johanson was employed by Debtor. Chris Snyder, a former
20 employee of Debtor’s, testified that he had seen Colt Johanson sitting in front of a

1 computer at Debtor's place of business over a three-month period, although Mr.
2 Snyder was unsure of the extent of Colt Johanson's work. Mr. Frye, who also
3 worked for Debtor, indicated that he was not aware of anything of value that
4 resulted from Colt Johanson's services to Debtor.

5 17. Evidence of payments to Colt Johanson includes W-2 wage and tax
6 statements indicating that \$21,983.17 in wages were reported for the years 2007
7 and 2008. P-91 at 1. Debtor's payroll records for the same period indicate that
8 Colt Johanson was paid \$18,158.99, which is roughly consistent with the amount
9 of Colt Johanson's wages reported on the W-2 forms, after the withheld taxes are
10 subtracted. *See* P-91 at 1, 2. Debtor also paid \$2,568.06 for a truck purchased in
11 Colt Johanson's name. P-91 at 4, 5. The evidence further reflects an additional
12 \$800.00 payment from Debtor to Colt Johanson, without any indication of whether
13 the funds were transferred as payment for Colt Johanson's services to Debtor. *See*
14 P-91 at 6.

15 18. Plaintiff also offered an accounting record as evidence of a \$1,113.25
16 payment that Debtor made to Colt Johanson, apparently for wages. *See* P-91 at 3.
17 However, the accounting record does not indicate the date of payment or whether
18 the payment is reflected also in the other payroll records. The Court finds that
19 Plaintiff has not offered sufficient evidence of this payment and excludes the
20 payment from its accounting of transfers that Colt Johanson received from Debtor.

1 19. There is no evidence that Colt Johanson invested funds in Debtor or
2 was aware of Debtor's Ponzi scheme.

3 20. The following summarizes the evidence of transfers made to Harold
4 Johanson:

5 Transfers of \$6,122.34 CAD

6 Transfers of \$1,166.66 USD

7 21. The following summarizes the evidence of transfers made to Colt
8 Johanson:

9 Wages net of taxes and withholdings	\$18,158.99 USD
Member withdrawal	\$800.00 USD
10 Partial payment for a truck	\$2,568.06 USD

11 22. Total transfers to Defendants are as follows:

- 12 • **Harold Johanson** for \$6,122.34 CAD and \$1,166.66 USD; and
- 13 • **Colt Johanson** for \$21,527.05 USD

14 23. All transfers to Defendants were made with actual fraudulent intent
15 to hinder, delay or defraud creditors and in furtherance of a Ponzi scheme.

16 24. All transfers were made to Defendants while Debtor was insolvent.

17 CONCLUSIONS OF LAW

- 18 1. This Court has jurisdiction of this proceeding pursuant to 28 U.S.C. §
1334 and 28 U.S.C. § 157(d).
- 19 2. This Court has jurisdiction over Defendants.
- 20 3. This action was timely commenced.

1 4. At least one unsecured creditor existed who triggered the strong arm
2 power of 11 U.S.C. § 544(b)(1) because the creditor did not and should not
3 reasonably have discovered the fraudulent nature of Debtor's Ponzi scheme
4 transfers within one year before the bankruptcy petition was filed. *See* 2:11-cv-
5 00362-RMP, ECF No. 197.

6 5. Defendants are insiders of Debtor. *See* 11 U.S.C. § 101(31)(A)
7 ("insider" includes a "relative of the debtor").

8 6. Washington State law governing fraudulent transfers applies.

9 7. Under the statutes relating to fraudulent transfers, 11 U.S.C. § 548
10 and RCW 19.40, *et seq.*, payments received from Debtor are recoverable from
11 each Defendant by the Trustee, subject to the defense of good faith pursuant to 11
12 U.S.C. § 548(c) and RCW 19.40.081(a).

13 8. Transfers made in furtherance of a Ponzi scheme constitute actual
14 fraud under the Bankruptcy Code and Washington's version of the Uniform
15 Fraudulent Transfer Act (UFTA). *See* Bankr. Adv. Proc. No. 11-80299-FPC, ECF
16 No. 378 at 21-25. "Where causes of action are brought under UFTA against Ponzi
17 scheme investors, the general rule is that to the extent innocent investors have
18 received payments in excess of the amounts of principal that they originally
19 invested, those payments are avoidable as fraudulent transfers" *Donell v.*
20 *Kowell*, 533 F.3d 762, 770 (9th Cir. 2008).

1 9. A transferee of a fraudulent transfer may keep funds that it took for
2 reasonably equivalent value and in good faith. *See* 11 U.S.C. § 548(c); RCW
3 19.40.081(a). As recipients of transfers that constitute actual fraud, the burden of
4 proof in establishing the affirmative defense of good faith is on Defendants. *In re*
5 *Agric. Research and Tech. Grp., Inc.*, 916 F.2d 528, 535 (9th Cir. 1990); 5
6 COLLIER ON BANKRUPTCY ¶ 548.09[2][c] at 548-98.2 (16th ed. 2011).

7 10. Although “good faith” is not defined precisely in case law, at least
8 one court has noted that the absence of good faith is shown by a transferee who
9 knows that a debtor is operating a Ponzi scheme. *See In re Agric. Research*, 916
10 F.2d at 535 (citing *In re Indep. Clearing House*, 77 B.R. 843, 861 (D. Utah
11 1987)). The Ninth Circuit has quoted favorably an explanation in an early case
12 that a transferee’s “knowledge or actual notice of circumstances sufficient to put
13 him, as a prudent man, upon inquiry as to whether his brother intended to delay or
14 defraud his creditors . . . should be deemed to have notice . . . as would invalidate
15 the sale as to him.” *Id.* (quoting *Shauer v. Alterton*, 151 U.S. 607, 621 (1894)).

16 11. Courts measure good faith by an objective standard, looking to what
17 a transferee “‘knew or should have known’ in questions of good faith, rather than
18 examining what the transferee actually knew from a subjective standpoint.” *Id.* at
19 536.

1 12. Under the Bankruptcy Code, Washington's UFTA, as well as
2 relevant case law, the Court does not contemplate a recipient's intent when
3 deciding whether to avoid fraudulent transfers. 5 COLLIER ON BANKRUPTCY ¶
4 548.04[2] at 548-63; *Thompson v. Hanson*, 168 Wn.2d 738, 749 (2009).
5 Accordingly, a transfer that constitutes actual fraud is avoided in its entirety
6 unless the transferee establishes that a reasonable person in the transferee's
7 position would not and should not have known of the fraud, not simply whether he
8 or she *actually* acted in good faith.

9 13. Transfers made by Debtor in furtherance of its Ponzi scheme are
10 transfers made with actual intent to hinder, delay and/or defraud creditors under
11 both state law, RCW Ch. 19.40, and federal law, 11 U.S.C. § 548(a)(1).

12 14. The Court is mindful that Defendant Colt Johanson did not appear at
13 trial or propose any exhibits to meet his burden of establishing that he acted in
14 good faith when he received payments from Debtor. However, after carefully
15 reviewing the exhibits and testimony, the Court concludes that the preponderance
16 of the evidence establishes that Colt Johanson acted in good faith. Unlike other
17 defendants in related adversary proceedings, there is no evidence that Colt
18 Johanson invested any funds in Debtor, which might have shown that he was
19 aware of factors that made Debtor's business fraudulent. Nor is there evidence
20 that Colt Johanson was involved in recruiting lenders for Debtor or otherwise

1 orchestrating the fraudulent aspects of the business. The evidence showed that
2 Colt Johanson was employed by Debtor, and indeed the majority of the transfers
3 that he received were wages.

4 15. The Court also finds that Colt Johanson gave Debtor reasonably
5 equivalent value for the wages that he received in exchange for employment with
6 Debtor. Although Plaintiff argued at trial that Colt Johanson's pay was unusually
7 high in light of the fact that he was employed by Debtor for only a few months,
8 the evidence showed that his paychecks were comparable to those received by
9 Debtor's other employees. *See* P-91 at 7-8, 10-13. Moreover, a former employee
10 testified that he had seen Colt Johanson at Debtor's workplace, and documentary
11 evidence indicates that federal taxes were withheld from his wages. While
12 Plaintiff speculated at trial that Debtor did not derive reasonably equivalent value
13 from Colt Johanson's services, the evidence indicates that this in fact was a
14 standard employment relationship. The Court concludes that the evidence shows
15 that Colt Johanson met the affirmative defense of good faith as to the **\$18,158.99**
16 **USD** that he received as wages.

17 16. However, there is no evidence that Colt Johanson gave reasonably
18 equivalent value for the \$800.00 member withdrawal or for the \$2,568.06 truck
19 payment. Thus, Colt Johanson has not met the affirmative defense as to **\$3,368.06**
20 **USD**.

1 17. There is not sufficient evidence to show that Harold Johanson gave
2 reasonably equivalent value in exchange for the transfers that he received from
3 Debtor.

4 18. Under RCW 19.40.041(a)(1), RCW 19.40.091(a) and the “strong arm
5 powers” that 11 U.S.C. § 544(b)(1) grants to bankruptcy trustees, all of Debtor’s
6 transfers to Defendant Harold Johanson, regardless of the date of transfer, are
7 hereby set aside and avoided.

8 19. Under RCW 19.40.041(a)(1), RCW 19.40.091(a) and the “strong arm
9 powers” that 11 U.S.C. § 544(b)(1) grants to bankruptcy trustees, Debtor’s
10 transfers to Defendant Colt Johanson for the member withdrawal and car payment,
11 totaling **\$3,368.06 USD**, regardless of the date of transfer, are hereby set aside and
12 avoided.

13 20. The Trustee is entitled to claw back and recover the transfers to
14 Defendants, in the amounts described above.

15 21. The Trustee is entitled to pre-judgment interest at the applicable
16 federal rate from July 21, 2009, when the bankruptcy case commenced.

17 22. Pursuant to 11 U.S.C. § 548(a), 544, 550 and 551 and RCW
18 19.40.041(1) and 19.40.071, the Trustee is entitled to and is granted a judgment
19 for the benefit of the Liquidating Trust of Debtor against **Harold Johanson in the**
20 **amount of \$6,122.34 CAD and \$1,166.66 USD**, plus pre-judgment interest from

1 July 21, 2009, at the applicable federal judgment rate and post-judgment interest
2 at the federal judgment rate from the date of judgment to the date the judgment is
3 paid in full, *see* 28 U.S.C. § 1961.

4 23. Pursuant to 11 U.S.C. § 548(a), 544, 550 and 551 and RCW
5 19.40.041(1) and 19.40.071, the Trustee is entitled to and is granted a judgment
6 for the benefit of the Liquidating Trust of Debtor against **Colt Johanson in the**
7 **amount of \$3,368.06 USD**, plus pre-judgment interest from July 21, 2009, at the
8 applicable federal judgment rate and post-judgment interest at the federal
9 judgment rate from the date of judgment to the date the judgment is paid in full,
10 *see* 28 U.S.C. § 1961.

11 24. The Trustee is entitled to reimbursement of its costs for pursuing this
12 action.

13 25. Trustee is awarded all applicable interest, costs and disbursements of
14 this action against each Defendant.

15 **IT IS SO ORDERED.**

16 The District Court Executive is directed to enter this Order and to provide
17 copies to counsel and to pro se defendants.

18 **DATED** this 18th day of November 2014.

19 _____
20 *s/ Rosanna Malouf Peterson*
ROSANNA MALOUF PETERSON
Chief United States District Court Judge